The Formula for a Successful Nonprofit Collaboration

By Laura Solomon, Esq.   16 September 2015

Each nonprofit collaboration, be it an affiliation, partnership, joint venture or merger, is unique because every nonprofit is different. All collaborations have distinct features and nuances. Over the past 22+ years working on these transactions, though, I have identified eight core elements of successful collaborations. I am pleased to share this “formula” in the hope that others in the sector can benefit from failed experiments and learn from my successes.

You will be tempted to skip one or more of the elements in the formula. You may sincerely think that there is no need to put anything in writing because you believe that you understand each other, and preparing a Letter of Intent (“LOI”) takes time that you feel you do not have. You will want to negotiate the terms as much as possible before involving your Board of Directors, because you believe it will save you time and aggravation. You may feel restricted by the mission statement on the plaque on the wall of your conference room, and who wouldn’t want to save money on legal fees if you can get pro bono?

Recognize these temptations. You will need to work through them, without simply reacting to them. Success will only come if you identify the challenges without allowing them to draw you off a deliberate, thoughtful path.

Agree on the Form

Nonprofit collaborations take many forms and professionals use the terms "affiliation," "collaboration," "partnership," "joint venture," and "merger" to describe different methods of collaboration -- but often the parties do not even agree on the meaning of the terms. For example, a larger organization seeking to take over a smaller, less sophisticated organization may use the term "affiliation" in place of "merger" because it is perceived to be less threatening and therefore more palatable to the target organization's Board of Directors. The danger here for the smaller organization is that its Board may not understand the substance and nature of the transaction.

I was once asked by a small nonprofit organization to terminate its affiliation. When I reviewed the affiliation agreement, I was forced to deliver the unwelcome news that my client had given the other nonprofit control of its organization and assets by ceding majority control of its Board of Directors. Therefore, my client was an asset "owned" by the larger nonprofit and had no ability to terminate what had been, in substance, a merger.

Do not assume that both parties are using the chosen term in the same way. Ask more specifically: "What do you mean by an affiliation?" One Executive Director may be envisioning a one-day arts program; the other may be hoping for a long-term partnership or joint venture.

As soon as you determine there is mutual interest for pursuing the collaboration, move as quickly as possible to articulate the basic terms in an LOI. Doing so will test out your assumptions and highlight the points of agreement and any gaps.

Execute A Letter of Intent

An LOI is a non-binding letter agreement that two (or more) nonprofits use to document their agreement to explore a potential collaboration. Key terms include: a description of the anticipated form of the transaction, an agreement to share confidential information with each other for due diligence review; and a proposed timeline. The LOI may include a binding confidentiality or non-disclosure provision or the parties may sign a separate, binding Confidentiality or Non-Disclosure Agreement. An LOI may also address messaging if the parties plan to make the proposed collaboration public.

Work with your lawyer to craft the LOI. The process of preparing and getting the LOI signed will highlight any differences in understanding between the parties and if successful, will document the meeting of the minds of the

parties - or not! I have had clients discover that they cannot get the other nonprofit to agree to the core terms for the LOI. That is good information that may inform a party not to proceed.

Some clients want to skip the LOI stage and begin drafting and negotiating the transaction documents. That is a mistake. It is much more efficient to craft an LOI and reduce the key terms to writing early. If you negotiate the agreement terms through a series of document drafts, you will find that it is more time consuming and thus much more expensive.

With the LOI in place, you will have established a process and allowed for time to begin the critically important due diligence process. Due diligence affords you, your legal counsel and accountants an opportunity to review the other party's documents to assess its financial health, potential liabilities and other issues that may affect your decision to collaborate.

Remember the Mission: It may seem obvious but we often neglect to consider whether the collaboration is in furtherance of your nonprofit's mission. You should consider the mission at the outset and throughout the negotiations. Ask also if your mission should be re-examined in light of the opportunity.

One of our clients, who conducts economic development in Philadelphia, was asked to collaborate with another

nonprofit to expand its programs to another city. Our client's Articles of Incorporation refer to Philadelphia, which means that the planned expansion would be outside the mission – but Articles can and should be changed to seize strategic opportunities. Your nonprofit's mission should not be static. A healthy, sustainable nonprofit will have an evolving and growing mission which responds to community needs and donor wishes in an effective way. A potential collaboration may be the right trigger for growth and change in strategic direction.

Nonprofit staff members and Board members may pursue or recoil from collaborations for different reasons unrelated to the mission. Those reasons may include: a potential grant, ego, personal financial gain, or a feeling that the transaction represents bankruptcy of the mission. If you keep the conversation focused on the mission, you will be able to steer clear of these distractions and dangers.

Assemble the Right Players

The best working group for collaboration will include Board and staff members at the outset, and often times, even funders. These individuals should have deep knowledge of and a commitment to the charitable mission and each will have different, important perspectives and contributions to the process. Consider also their personalities. Negotiations can be protracted and tense. It will serve you well to choose individuals who can be

calm and analytical in the face of challenges.

Don't forget to ask about the team assembled by the other nonprofit. If the other Executive Director is not sharing information with his or her Board, that should alert you that there is a problem. Bring it up and address it directly, and insist on Board involvement. If you do not, you could be negotiating a collaboration in earnest only to discover that you have wasted your time and the organization's resources because the other side's Board will ultimately reject it.

I have seen Executive Directors try to implement a collaboration without Board input and Directors that attempt to do the same without staff participation. Each is a mistake. The Board needs to understand and be "on board" with a proposed collaboration. In fact, the fiduciary duties of the Board members require that they exercise care and loyalty in diligence as they review the collaboration to assure that it is in furtherance of the mission and in compliance with the law. Excluding the Board from the process will backfire because the staff will find that the Board is not in agreement with the terms and therefore willing to authorize it – at which point the transaction will come to a grinding halt.

Likewise, a Board that attempts to implement an affiliation without staff participation will regret it in the long term. I once heard from a client whose Board pushed through a merger that was the equivalent of a "shotgun wedding."

The Executive Director told me that it took three years to work out difficult cultural and organizational issues that should have – and could have been addressed up front.

Hire Your Own Qualified Counsel Early

You will need seasoned legal counsel with extensive experience in corporate, tax, and transactional matters for nonprofit, tax-exempt organizations. There are many well-meaning, excellent lawyers who are willing to donate their time pro bono to nonprofits – but beware: pro bono is only pro bono if the lawyer is qualified. Failure to hire the right counsel will jeopardize the transaction and waste your organization's precious resources. It could even result in fines, penalties and personal liability for Directors and Officers if the transaction is not implemented properly.

I have a longstanding client that decided to rely on the pro bono counsel of the other party to draft the merger documents. The pro bono counsel was a young, for-profit corporate lawyer with no knowledge of the tax status, implications and regulatory approvals required for a merger of two tax-exempt organizations. As a result, the transaction took much longer and was much more expensive for our client, because we had to fix and redraft the documents and teach the pro bono lawyer what went wrong. The client apologized at the closing table and said he regretted the decision.

Understand also that you need your own counsel; the two parties may not share counsel for a transaction. A collaboration is often a "fundamental transaction," so significant that parties cannot waive the inherent conflicts. A lawyer is prohibited by ethics rules and should not represent the interests of both parties.

Involve your counsel early in the process. You may be tempted to negotiate the deal on your own and then bring the lawyer in to "just document it," but you will regret his later. Qualified counsel will be able to assist in due diligence and otherwise spot issues (tax classification, restricted assets) early that may dictate timing, the form of the transaction and required regulatory approvals from the Attorney General and/or a Court. If the issues are not identified early, it will be expensive to change course or clean things up later. You may even need to unwind the transaction!

Remember, a Collaboration is a Relationship: The relationship between two nonprofit organizations in a collaboration is not unlike a relationship between two people. A healthy collaboration requires wisdom, patience, respect and an opportunity to get to know each other. Collaborating nonprofits benefit from a chance to "date" and get to know each other, its culture and quirks before getting engaged or married. In fact, many successful nonprofit mergers are preceded by an "affiliation" period and some merger agreements even include a "divorce" or termination clause.

You will likely find that the process to negotiate and conclude the transaction takes a lot of time, energy, and patience, and you will discover that it's more of a marathon than a sprint. Rushing collaboration is like running off to Vegas with the person you just met. You will likely have regrets the morning after. Many funders have learned that forced collaborations, which are the equivalent of arranged marriages, flounder because the parties are not vested in the decision.

Set Realistic Expectations About Timing

Certain nonprofit collaborations like mergers, asset transfers, and joint ventures may take upwards of a year to implement. That is because regulatory approvals—from the Attorney General's Office or Court approvals, tax clearances and Board approvals—will be required. Your lawyer should explain and prepare a timeline for the collaboration. It will include: execution of the LOI; a 60-90 day due diligence period; preparation and negotiation of the core transaction documents; approvals of each of the Boards of Directors; regulatory approvals; and closing.

If your nonprofit is negotiating the collaboration because it is in dire financial straits, make that clear so that you can request a bridge loan or other financial assistance from the other party. If the other party is rushing to the finish line, ask why. You will want and need to know if the other nonprofit is facing a litigation matter, tax liens or frustrated

creditors. Desperation in nonprofit collaborations – as in personal relationships – should give you pause.

Explain the timeline to your Board and staff. Board members get fatigued by this process and sometimes lose interest or want to distance themselves from it if they disagree with the plan. Ask your lawyer to speak with Board members and explain that their fiduciary duties to the organization continue until the transaction has concluded. You may need to consider employment agreements, and even retention bonuses for key staff members to retain good talent necessary to implement the collaboration.

Get Everyone In One Room

It may sound old fashioned, but it works. After the LOI is signed, your due diligence has concluded, and you have distributed the draft transaction documents for review, hold a working group meeting with the teams and legal counsel from each side to negotiate changes to the documents. This meeting may be long, and difficult. It may even take a day – or days, and you may have to repeat it two or more times. I promise though, that it is the best, most efficient approach.

Getting people to talk to each other directly, instead of through lawyers or documents, avoids months of email exchanges and drafts that could erode the goodwill of the parties and jeopardize the transaction. Many

collaborations veer off track and eventually collapse when parties are lobbing aggressively drafted documents at one another.

I hope you will use my formula for many successful nonprofit collaborations and I welcome you to contact me at Laura@LauraSolomonEsq.com with your stories and feedback.

About the Author: Laura Solomon, Esq. is the founder of Laura Solomon & Associates (www.LauraSolomonEsq.com), a law firm devoted to the representation of nonprofits. Laura and her associates act as outside counsel to hundreds of charitable organizations, structuring and implementing affiliations, joint ventures, mergers, and complex financial transactions.